

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE FEASIBILITY)	
OF IMPLEMENTING DEMAND-SIDE)	ADMINISTRATIVE
MANAGEMENT COST RECOVERY AND)	CASE NO. 341
INCENTIVE MECHANISMS)	

O R D E R

The Commission initiated this proceeding on July 24, 1992, for the purpose of investigating the feasibility of designing and implementing mechanisms for the recovery of costs related to electric utility demand-side management ("DSM") programs, the recovery of revenue losses resulting from DSM programs, and the provision of financial incentives to electric utilities that undertake cost-effective DSM programs. In its initial Order the Commission identified certain issues to be researched and analyzed in the investigation and directed the following electric utilities to file written responses to questions pertaining to those issues: Big Rivers Electric Corporation, East Kentucky Power Cooperative, Inc., Louisville Gas and Electric Company ("LG&E"), Kentucky Power Company, Kentucky Utilities Company, and The Union Light, Heat and Power Company (collectively "the utilities"). Other interested parties were encouraged to file responses as well.

Responses were filed by each of the utilities, either individually or jointly. Other parties filing individual responses were Cumberland Valley Rural Electric Corporation, Kentucky Industrial Utility Customers ("KIUC"), Kentucky Cabinet for Natural

Resources and Environmental Protection's Division of Energy, Kentucky Association for Community Action, and Louisville Resource Conservation Council. Filing joint comments were: Jefferson County Government, the Office of the Attorney General, and Lexington-Fayette Urban County Government; and Metro Human Needs Alliance, People Organized and Working for Energy Reform, Citizens Organized to End Poverty in the Commonwealth, Anna Shed, and Marvar Cowart. The following gas utilities filed comments: Delta Natural Gas Company, Inc., Western Kentucky Gas Company, and Columbia Gas of Kentucky, Inc.

After reviewing these initial responses the Commission directed many of the parties to provide further information, either in support of their stated positions or as comment on other parties' positions. Those responses were filed in February and March of 1993.

In April 1993, LG&E and several of the non-utility parties to this case filed a joint application for approval of DSM programs and a DSM cost recovery mechanism.¹ The DSM proposals in Case No. 93-150 raised fundamental statutory questions and concerns regarding the Commission's review and treatment of DSM cost recovery proposals. Case No. 93-150 was decided by the Commission in November 1993.

¹ Case No. 93-150, A Joint Application for the Approval of Demand-Side Management Programs, a DSM Cost Recovery Mechanism, and a Continuing Collaborative Process on DSM for Louisville Gas and Electric Company.

The Kentucky General Assembly enacted legislation earlier this year allowing the Commission to review and approve utility DSM plans and DSM cost recovery, lost revenue recovery and financial incentive proposals either as part of a proceeding for approval of new rate schedules pursuant to KRS 278.190 or in a separate proceeding limited to DSM and related rate-recovery issues.

RESPONSES AND COMMENTS

The utilities and other parties provided extensive comments on the issues identified in this proceeding. Those comments covered such issues as: (1) whether utilities should pursue DSM in the development of future resource plans; (2) whether the Commission has the statutory authority to establish financial incentives to encourage a utility's use of DSM; (3) the specific cost-benefit tests that should be employed in evaluating the cost-effectiveness of DSM programs; (4) the different methods by which utilities can recover DSM-related costs; (5) the perceived advantages and disadvantages of the different cost recovery methods; and (6) the concerns related to monitoring and evaluating DSM programs that have been implemented.

The comments displayed a wide range of opinion among the parties on many of the issues. However, with the exception of KIUC, which opposed establishing cost recovery mechanisms and financial incentives for DSM, there was a consensus among the parties on certain issues such as: (1) the importance of allowing DSM programs, recovery mechanisms and incentives to be developed on a utility-by-utility basis, i.e. the need for flexibility; (2) the

preference for a shared savings mechanism as the means of providing financial incentives for the development of DSM; and (3) the dislike for rate of return adjustments or bounties as a means of providing financial incentives for DSM.

CONCLUSIONS

The Commission has considered the responses of the parties, the statutory issues raised herein and in Case No. 93-150, and the recent enactment of House Bill 501 in deciding this case. We have concluded that the utilities should consider and pursue cost-effective DSM in the development of future resource plans just as they would consider any supply-side resource. House Bill 501 has given the Commission the statutory authority to establish cost recovery mechanisms and financial incentives to encourage a utility's use of DSM. The Commission will judiciously and carefully exercise that authority.

While there are some areas of consensus among the parties, particularly on the matter of methods for creating financial incentives for DSM, the Commission will not prescribe a generic approach or methodology for recovering DSM program costs and lost revenues or creating financial incentives for the implementation of cost-effective DSM programs. Utilities should have the flexibility not only to develop utility-specific DSM programs but also utility-specific cost recovery and financial incentive mechanisms.²

² The Commission recognizes that many of these incentive issues do not pertain to cooperative utilities. We encourage cooperatives to develop DSM programs and cost recovery mechanisms that reflect their specific needs and requirements.

Given the myriad DSM program and cost recovery options available and the relative newness of these issues in Kentucky, we conclude that these matters are best handled on a case-by-case basis as they are presented to the Commission. However, there are a few generally applicable matters that can be addressed at this time. The Commission expects the utilities under its jurisdiction to pursue cost-effective DSM resource options that have undergone the same rigorous evaluation and consideration as applied to prospective supply-side resources. Furthermore, demand-side and supply-side resource options should be evaluated in an integrated analysis that determines the most reasonable mix of long-term resources.

In evaluating the cost-effectiveness of DSM programs, the utilities should consider the cost-benefit methodologies devised by the California Public Utilities Commission and California Energy Commission in their Standard Practice Manual for Economic Analysis of Demand-Side Management Programs. Specifically, the utilities should consider from the following cost-benefit tests those that are best suited for their operations and resource needs: the Total Resource Cost Test, the Utility Cost Test, the Ratepayer Impact Measure Test, the Participant Test and the Societal Test. These tests should be familiar to the electric utilities as they have been included in the DSM evaluation of the integrated resource plans they filed in 1991 and 1993 pursuant to 807 KAR 5:058. However, recognizing that new cost-benefit tests and methodologies for DSM programs may be developed in the future, none will be

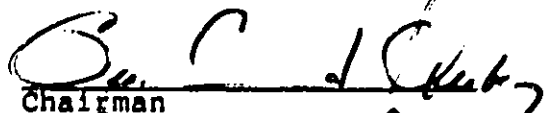
prescribed. Rather, the Commission will consider the methodologies enumerated above or alternative tests on a case-by-case basis in utility proposals.

House Bill 501 enumerates several factors to be considered by the Commission in determining the reasonableness of a utility's DSM proposals. The specified factors are not exclusive but may be supplemented by the Commission in its discretion to meet the facts and circumstances of particular proposals. No one factor is to be given controlling weight and all relevant factors will be thoroughly analyzed based on the supporting information. The Commission will take this opportunity to remind all concerned of two points that should be obvious: 1) the filer of a DSM proposal under House Bill 501 is an applicant and, under long-standing legal principles, bears the burden of proof to support its proposals by substantial evidence; and 2) a proposal to recover DSM costs through rates constitutes a change in rates that triggers the notice requirements set forth in 807 KAR 5:011, Section 8(2) and (3).

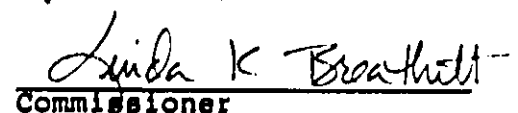
IT IS THEREFORE ORDERED that the instant investigation be and it hereby is concluded.

Done at Frankfort, Kentucky, this 14th day of July, 1994.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director